



NON-PROFIT MANAGEMENT UPDATE

FALL 2008

CASE DEVELOPMENTS

Provided by

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STANDING UNDER THE ADA

A non-profit corporation must demonstrate that it, or those on whose behalf it files suit, will suffer injury in order to have standing under the Americans with Disabilities Act ("ADA"). Disability Rights Wisconsin, Inc. ("DRW"), a non-profit corporation, filed suit against the Walworth County Board of Supervisors alleging that its approval of the construction of a separate facility for disabled children violated the ADA and the Rehabilitation Act of 1973. The court held that DRW lacked standing both to sue in its own right and to bring suit on behalf of school-aged disabled children in Walworth County. DRW had to not only allege harm to the disabled children, but also had to allege an injury to itself, such as an increased expenditure of time, money and resources as a result of the new school construction. The court also held that DRW lacked associational standing because it did not adequately establish that the disabled children had or would sustain any injury as a result of the project. Finally, if the students were to suffer an injury as a result of the project, the Individuals with Disabilities Education Act establishes a process through which such children remain free to bring suit on their own behalf or through representation by DRW. *Disability Rights Wis., Inc. v. Walworth County Bd. of Supervisors*, 522 F.3d 796 (7th Cir. 2008).

ECCLESIASTICAL ABSTENTION DOCTRINE

Two recent cases have addressed the ecclesiastical abstention doctrine as applied to non-profit organizations. *Baldonado v. Way of Salvation Church*, 185 P.3d 913 (Haw. Ct. App. 2008) and *White v. Board of Directors of St. Elizabeth Baptist*

Church, 974 So.2d 164 (La. Ct. App. 2008). The doctrine arises out of the First Amendment to the United States Constitution and case law from the United States Supreme Court, which guarantee religious freedom and forbid courts from interfering in the ecclesiastical matters of hierarchical religious groups. In *Baldonado* and *White*, the appellate courts concluded that the doctrine applied only where the matters were purely ecclesiastical; in other circumstances, the issues were governed by state non-profit laws.

In *Baldonado*, members of a congregational church, who had been expelled by the church, brought an action against the church and its directors and officers alleging that the church had been run for profit and had misused funds for the pastor's benefit. A Hawaiian appellate court concluded that the expelled members had standing to sue because the issues they raised were not purely ecclesiastical as there was no interference with hierarchical church doctrine. Thus, the state non-profit law was applicable and the lawsuit was permitted to proceed.

In *White*, a congregation member of St. Elizabeth Baptist Church, Murphy White, filed suit seeking an injunction against Reverend Moses Hughes barring him from continuing to perform his duties. White accused Hughes of various conduct alleged to be both nefarious and outside the scope of his authority. Reverend Hughes allegedly allocated church funds for personal use and facilitated a visit by a guest preacher who brandished a knife in the church as a threat to any would-be challengers to Hughes's actions. White also claimed that while the church's charter required an annual election, one had not been held for ten years. The court refused

to enjoin Hughes from continuing to carry out his duties as Reverend, explaining that it would be an unconstitutional interference with the ecclesiastical matters of a religious group. However, the court held that it was within the trial court's authority to appoint a special master to oversee a proper election of the board of directors because ensuring that a board election is in compliance with the church's charter is not a purely ecclesiastical matter and, therefore, is subject to the state's non-profit laws.

BYLAW INTERPRETATION

An appointed director of the Martindale Brightwood Community Development Corporation ("MBCDC"), an Indiana non-profit corporation, lacked standing to sue because the non-profit's bylaws defined directors as "elected" individuals. Mark Bryant and Patricia DeWalt, a former director and executive director, respectively, argued that, as directors, they had a right to seek an injunction or declaratory judgment against the board of MBCDC pursuant to the Indiana Non-profit Corporation Act ("the Act"), which permits directors to bring suits. Although the Act defines director as an individual who is either "elected or appointed," a non-profit corporation is free to limit the definition of a director in its bylaws to an elected individual. Because DeWalt was not elected she was not considered a director under MBCDC's bylaws and therefore had no standing. Bryant, an elected director, did have standing to bring suit. *Martindale Brightwood CDC v. Gore*, 878 N.E.2d 1280 (Ind. Ct. App. 2008).

BYLAWS CONFLICTING WITH ARTICLES OF INCORPORATION

When a bylaw of a non-profit corporation conflicts with its articles of incorporation, the conflicting provisions of that bylaw are invalid. Amendments passed under the invalid bylaw's voting procedure are likewise invalid. The Nevada Classified School Employees Association ("NCSEA") sought to prevent one of its chapters from disaffiliating, claiming that the chapter did not receive a two-thirds vote as required by the amended bylaws. However, the voting procedure contained in the bylaws that was used to pass the amendment capped the total number of delegates per chapter, regardless of a chapter's membership. This was inconsistent with NCSEA's articles of incorporation, which required that all members of the corporation have equal voting power. The court held that both the amendment and the voting procedure which passed it were invalid because they conflicted with the articles of incorporation. *Nev. Classified School Employees Ass'n v. Quaglia*, 177 P.3d 509 (Nev. 2008).

ATTORNEY'S FEES

Park Ridge Condominium Association, Inc. ("the Association") appealed a decision by a Georgia trial court which ordered it to pay a member's attorney's fees after finding that the Association had acted in bad faith by refusing her request to inspect the Association's books. The court of appeals upheld the trial court's decision that the member had a proper purpose for the request and that the Association's refusal was in bad faith. However, the court reversed the trial court's award of attorney's fees because the relevant statute only permits recovery of costs expended to obtain an order to inspect records, and not all litigation costs. *Park Ridge Condo. Ass'n, Inc. v. Callais*, 660 S.E.2d 736 (Ga. Ct. App. 2008).

CHARTER REVOCATION

A non-profit corporation lacks standing to bring claims for injuries sustained while its charter was revoked, even if at the time the claims are brought the charter has been reinstated. The Equal Rights Center ("ERC") brought a discrimination claim against Jonathan Woodner Co., a property management company, after several of ERC's employees allegedly encountered income discrimination when posing as potential renters. These encounters allegedly occurred during a time when ERC's articles of incorporation had been revoked for failure to comply with filing requirements. The court granted Jonathan Woodner Co.'s motion to dismiss all claims for injuries suffered during the period that ERC's charter was revoked due to lack of standing. The court also held that landlords remain free not to rent to Housing Choice Voucher Program participants, as long as they do so for reasons not based on income discrimination. *Bourbeau v. The Jonathan Woodner Co.*, 549 F. Supp. 2d 78 (D.D.C. 2008).

HEALTH CONCERNS WITH LAND DEVELOPMENT

The Rochester Buckhart Action Group ("Rochester"), a non-profit corporation, challenged the construction of a hog farm facility on Robert Young's property alleging detrimental effects on the health and well-being of the community. The Illinois trial court granted a preliminary injunction to prevent Young from further construction or operation of a hog farm on his property. The appellate court reversed the decision and lifted the preliminary injunction on the grounds that, under Illinois law, the hog facility was not considered a new facility but rather an improvement to existing infrastructure because its cost was less than 50% of the cost of a completely new construction project. Because the

hog farm was not considered a new facility, it was not subject to the setback requirements that Rochester alleged Young was violating in its preliminary injunction request. Rochester Buckhart Action Group v. Young, 887 N.E.2d 49 (Ill. App. Ct. 2008).

TAX TREATMENT OF PROPERTY LEASED BY A NON-PROFIT

A non-profit corporation may be exempt from paying state taxes on facilities it rents out to private parties if the use of such facilities is related to the exempt purposes of the non-profit. Willis Knighton Medical Center's ("WKMC") tax exempt status is based on its purpose of providing treatment for sick and diseased human beings. The Louisiana state court of appeal held that WKMC is entitled to a refund for property taxes paid for office space that it leased to private physicians because the use of such property was consistent with its exempt purpose. The court noted that even though the building is not physically connected to the WK Bossier Health Center Hospital, it is in close proximity and located on real property owned by the non-profit. The court further reasoned that the lease of the property was consistent with the goal of WKMC despite the fact that the physicians occupying the office space do not always refer patients to the WK Hospital. Willis Knighton Med. Ctr. v. Edmiston, 979 So.2d 656 (La. Ct. App. 2008).

TAX EXEMPT STATUS FOR CHARITABLE PROPERTY

A landowner must put his land to some public use in order to qualify for a charitable tax exemption. The property does not have to be constantly accessible by the public, but it must be available, to some degree, for leisure or educational purposes. In other words, mere nonuse is not sufficient to claim a charitable exemption. The Superior Court of Connecticut held that Aspetuck Land Trust ("Aspetuck") had not used its property sufficiently to achieve tax exempt status for the year 2005. Specifically, the court noted that Aspetuck did not issue any public information about the island it owned and no school groups had visited the island during the course of the year. Aspetuck Land Trust v. City of Bridgeport, 947 A.2d 32 (Conn. Super. Ct. 2008).

ORGANIZATIONAL TEST FOR TAX EXEMPTION

For an organization to exist exclusively for tax exempt purposes its articles of organization must:

(1) limit the purposes of the organization to those that are tax exempt; (2) not authorize the organization to engage in activities that do not further an exempt purpose; and (3) contain a provision that dedicates its assets to an exempt purpose upon dissolution. The United States Tax Court denied Solution Plus, Inc. tax exempt status for its failure to meet this test. The court reasoned that Solution Plus did not dedicate in its charter, or intend to dedicate, all of its activities to educational or charitable purposes. Solution Plus's primary activity was development and operation of its debt management programs. The corporation and its members stood to benefit financially from these programs and they did not offer services to only those in low income brackets. Solution Plus, Inc. v. Comm'r of Internal Revenue, 95 T.C.M. (CCH) 1097 (2008).

FREEDOM OF INFORMATION ACT

Exemption 5 of the Freedom of Information Act ("FOIA") applies to communications between a government agency and outside consultants that exist for the purpose of aiding the agency's deliberative process. The court held that the Department of Defense ("DoD") could exempt communications with non-government lawyers as intra-agency communications under Exemption 5 from a FOIA request made by the National Institute of Military Justice ("the Institute"). The Institute sought communications between non-government consultants and the DoD concerning the development of a military tribunal process by which suspected terrorists were to be tried under a Military Order by the President of the United States. The court reasoned that if agencies' deliberative processes with outside consultants took place in the public view, it would inhibit frank discussion of important policy matters. Nat'l Inst. of Military Justice v. U.S. Dep't of Defense, 512 F.3d 677 (D.C. Cir. 2008).

OTHER DEVELOPMENTS

REVISED INSTRUCTIONS FOR THE REDESIGNED IRS FORM 990

On August 19, 2008, the IRS released the revised instructions for the redesigned Form 990, *Return of Organizations Exempt from Income Tax*. The revised instructions are available on the IRS's website at: www.irs.gov/eo. Although the final version of the redesigned instructions will not be released until "late 2008," the IRS "intends that there will be no significant changes in content." The release of the revised instructions essentially completes the IRS's 15 month process of

overhauling Form 990. The revised instructions take into consideration, and incorporate, the 120 public comments the IRS received during the public comment period, which was open from April 7, 2008 to June 1, 2008. The revised version of the instructions provides filing organizations with additional clarity in many areas.

Of particular interest, the revised instructions redefine who constitutes a “key employee,” and, for the first time, describes the level of internal inquiry necessary to respond to questions regarding corporate governance and/or how much reportable compensation a director, officer, trustee, key employee or highly compensated employee received from related organizations. Regarding the definition of “key employee,” the revised instructions set forth a three-pronged test. A “key employee” is defined as one of the 20 highest compensated employees, who received at least \$150,000 of reportable compensation, and either influenced the organization in a fashion similar to a director, officer, or trustee; “manage[d] a discrete segment or activity of the organization that represents 10% or more of the [organization’s] activities ...; or ha[d] authority to control or determine 10% or more of the organization’s capital expenditures, operating budget, or compensation for employees.” As for the extent of inquiry a filing organization must undertake when responding to who is, or is not, “independent” for the purposes of corporate governance, and/or how much reportable compensation a director, officer, trustee, key employee or highly compensated employee received from related organizations, a “reasonable effort” is required. According to the IRS, a “reasonable effort” may include sending the relevant personnel an annual questionnaire that asks questions pertinent to the various filing requirements.

With these, and many other clarifying instructions, organizations required to file the redesigned Form 990 in 2009 (i.e., organizations with gross receipts over \$1 million or total assets over \$2.5 million) can, and should, begin to prepare.

PROTECTING OUR CHILDREN COMES FIRST ACT OF 2007

The Protecting Our Children Comes First Act of 2007 (“the Act”) became law on June 3, 2008. See Pub. L. No. 110-240. This Act amends the Missing Children’s Assistance Act to authorize appropriations through 2013 and increasing the funding to \$40,000,000 for fiscal year 2008 and such sums that are necessary for the years 2009 through 2013.

NEWBORN SCREENING SAVES LIVES ACT OF 2007

The Newborn Screening Saves Lives Act of 2007 (“the Act”) became law on April 24, 2008. See Pub. L. No. 110-204. This Act amends the Public Health Service Act to establish grant programs to provide for education on newborn screening and coordinate follow up care. The Act also reauthorizes certain programs under Public Health Service Act.

REPORTS

In May 2008, the Urban Institute released a report titled “Boards of Midsize Nonprofits: Their Needs and Challenges.” The report focused on several areas, including board engagement, CEO/Executive Director assessment of board performance and board recruitment and composition. The study shows that most heads of midsize nonprofits give their trustees low marks for fundraising and monitoring board performance. The study broadly concludes that discussions of non-profit leadership challenges should focus not only on CEOs, but on boards as well, and that measures should be taken to engage and strengthen boards. The report recommends three steps for mid-size non-profit boards to take immediately: (1) carefully assess board recruitment criteria and their fit with the organization’s needs; (2) attract well-rounded board members and consider an array of backgrounds and skills; and (3) promote a culture that encourages board members to help set the board’s agenda rather than concentrate influence solely in the hands of the CEO or board chair. The report is available on the Urban Institute website at: www.urban.org/publications/411659.html.

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